IT 01-0074-GIL 09/28/2001 SUBTRACTION MODIFICATIONS – OTHER RULINGS

> General Information Letter: ERISA does not prohibit the taxation of a voluntary employee benefits association. Letter rulings IT 90-0073, IT 93-0017 and IT 93-0017 are revoked.

September 28, 2001

Dear:

This is in response to your e-mail dated August 7, 2001 in which you state the following:

> I have an income tax question relating to the applicability of Illinois' income tax to a voluntary employee benefits association ("VEBA"). In Illinois Private Letter Ruling IT 90-00-0073 (March 15, 1990) the Illinois Department of Revenue ruled that the Employee Retirement Income Security Act of 1974 ("ERISA") preempted the Illinois income tax as it applied to the taxation of the unrelated business taxable income of a VEBA. Is this still Illinois' position? I ask because this PLR was issued during the "height" of the U.S. Supreme Court's ERISA preemption doctrine, and ERISA preemption has gone through many vicissitudes over the past 11 years. If you could lead me to any subsequent administrative or court materials on this question, I would greatly appreciate it.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill.Adm.Code §1200, or on the website http://www.revenue.state.il.us/legalinformation/regs/part1200.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

**Background**

Subsequent to the Tax Reform Act of 1984, a charitable organization's federal taxable income was determined by its unrelated business income ("UBI") as determined by Section 512 of the Internal Revenue Code ("IRC"). Section 205 of the Illinois Income Tax Act ("IITA") also defines a charitable organization's state taxable income as the UBI as determined by Section 512 of the IRC. As you may know, a VEBA is a charitable organization as defined by Section 501(c)(9), and thus a VEBA's federal taxable income includes its UBI. On March 15, 1990, in the wake of a series of United States' Supreme Court decisions interpreting ERISA preemption of state laws, the Illinois Department of Revenue issued IT 90-0073. This ruling contained the Department's determination that Illinois' calculation of a VEBA's state taxable income was preempted by ERISA based upon the United States Supreme Court's prior decisions.

In 1993, the Department issued two rulings, IT 93-0017 and IT 93-0187 confirming the Department's determination in IT 90-0073 that Illinois' calculation of a VEBA's state taxable income was preempted by ERISA.

**Discussion**

Throughout the 1980's, the United States Supreme Court interpreted the preemption language found at Section 514(a) of ERISA, 29 USC § 1144(a), very broadly. The Court's early decisions indicated that ERISA's preemption of any and all state laws insofar as they may now or hereafter relate to any employee benefit plan' would be considered to preempt nearly all state action having any effect on a VEBA. Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825, 829 (1988). The Court stated that a law 'relates to' an employee benefit plan if it has a connection with or reference to such a plan. Id. By 1989, the lower Federal Courts described one limiting factor to the prior interpretation of ERISA's preemption of state law. These lower courts stated that in order to be preempted, the state law must purport to regulate a plan by attempting to reach in one way or another the terms and conditions of the plan. Hydrostorage, Inc. v. Northern Cal. Boilermakers Local Jt. Apprenticeship Comm., 891 F.2d 719, 729 (9th Cir. 1989). In 1991, the Federal Courts began to define the limits of the ERISA preemption (see for example Losada v. Golden Gate Disposal Co., 950 F.2d 1395, 1400 (9th Cir. 1991), however, the United States Supreme Court had not made a determination regarding its prior rulings.

In 1995, the United States Supreme Court again took up the issue of ERISA preemption. Lower Courts had struggled with the application of differing Supreme Court decisions, thus leading to inconsistent rulings. The Supreme Court attempted to clarify its prior decisions with its decision in New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Company, 514 U.S. 645 (1995). (Please note that Roland W. Burris, then Attorney General of Illinois, filed an amicus curiæ brief with the Court urging reversal of the lower Court's ruling).

The Court in Travelers held that the ERISA regulations do not go about protecting plan participants and their beneficiaries, but instead control the administration of benefit plans by imposing reporting and disclosure mandates, participation and vesting requirements, funding standards and fiduciary responsibilities for plan administrators. ERISA's controls include Section 514 which preempts certain state laws.

It was Section 514's general language (ERISA "shall supersede any and all State laws insofar as they … relate to any employee benefit plan" covered by the statute), and the Supreme Court's interpretation of the same, which created much of the confusion in the lower courts. The Court surmised that if a literal application of "the term 'relate to' were taken to extend to the furthest stretch of its indeterminacy, then for all practical purposes preemption would never run its course, for really, universally, relations stop nowhere." Travelers at 655. The Court determined that such a literal reading would result in reading Congress's words of limitation as mere sham, and to read the presumption against preemption out of the law whenever Congress described preemption generally. Therefore, the Court held that it was necessary to look beyond the language of the statute and examine the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive.

The Court determined that ERISA's preemption clause was designed to avoid a multiplicity of regulations in order to permit the nationally uniform administration of employee benefit plans. Travelers at 657. Thus, state laws that mandate employee benefit structures or their administration, such as those examined in the Court's prior decisions, are preempted. State laws, even where there is an indirect economic influence on an ERISA plan, are not preempted unless the law precludes uniform administrative practice or the provision of a uniform interstate benefit package. The Court

determined that cost-uniformity was not the object of preemption, and that state laws that only have an indirect economic effect on the relative costs of various health insurance packages in a given state are not "conflicting directives" from which Congress meant to insulate ERISA. Travelers at 663. The Court acknowledged that many state laws have indirect economic effects on a plan's costs and, in fact, nothing in the language of ERISA indicates that Congress intended to displace the myriad of state laws in areas traditionally subject to local regulation. Finally, of note to your question, the Court pointed out that laws pertaining to disparate tax treatment of tax-exempt health care plans and commercial ERISA plans do not "relate to" ERISA, and are therefore not preempted. Travelers at 664.

The issue of ERISA preemption was decided in no fewer than 16 cases by the United States Supreme Court, and had generated an avalanche of litigation in the lower courts. Buono v. NYSA-ILA Medical and Clinical Services Fund, 520 U.S. 806, 808 (1997). In 1997, the Supreme Court addressed the issue three times. Id. The decision in Buono is of note because the Court's decision upheld a New York law imposing a 0.6 percent tax of general applicability on gross receipts for patient services at hospitals, residential health care facilities, and diagnostic and treatment centers.

Section 205 of the IITA is an Illinois State tax of general applicability on the unrelated business income of organizations that are exempt from federal income tax by reason of Section 501(a) of the IRC. Section 205 of the IITA is not directed specifically at ERISA plans, nor does it mandate employee benefit structures or their administration. Section 205 of the IITA does not preclude uniform administrative practices or the provision of a uniform interstate benefit package. Furthermore, state taxation of personal, business and the unrelated business income of charitable organizations is one of the myriad of State laws in areas traditionally subject to local regulation.

Accordingly, it is the Illinois Department of Revenue's determination that Section 205 of the IITA is not preempted by Section 504 of ERISA, and the VEBA's unrelated taxable business income, as determined under Section 512 of the IRC, shall be its base income, without deduction for the tax imposed by the IITA. The Department's position as described in IT 90-0073, IT 93-0017 and IT-0187 is hereby rescinded, and the regulations pertaining to income not exempt from Illinois income taxation will be amended to reflect the Department's determination. (See 86 Ill. Adm. Code 100.2470(h)).

Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Matthew S. Crain
Staff Attorney -- Income Tax